Q4 2019 NEWSLETTER

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Cloud Storage Transition

Our growing client base demanded an upgrade to an appropriate cloud storage solution. We've successfully transitioned all active and inactive client files from Dropbox over to Box. Your Dropbox shared folder will no longer be active.

Financial Planning Association (FPA) National Conference Presentation

Ashley was honored to present to his peer cohort at the National FPA conference in Minneapolis, MN. His presentation, entitled 'The Professionalization of Financial Advice, what the US might learn from the Australian experience' was well received.

Addition of InvestingYou for Financial Coaching

We are excited to add yet another value-enhancing tool to our repertoire - introducing InvestingYou, a strengths, values, goals and well-being tracking and measuring tool. This will be rolled out across our client base through 2020.

Welcome to 2020!

We have just completed the final quarter, not only of the year, but also the decade, so it's as good a time as any to reflect back on the market behavior for the past year, and also for the past 10 years. The short version is that we have experienced a bull market for the entire ten-year period, with no -20% bear market periods and only a few 10% corrections since June 2009. People who record the history of the markets will remember that the investors of the 2010s participated in the longest bull market in American history--a totally improbable event considering that the decade came right after one of the most dramatic market setbacks in modern times.

Let us not get too soft! We are long overdue for a correction, be it a run-of-the-mill 15% decline, an official 'Bear Market' decline of 20%+, or a once in a decade 40%+ decline. Whatever the decline and whenever it may finally arrive (both of which are totally unknowable) we can, with certainty, predict that the media will respond with their usual "THE END IS HERE... SELL EVERYTHING NOW". We, of course, will NOT sell, as our portfolios have been carefully designed for times like these.

Twin Cities Financial Planning Day

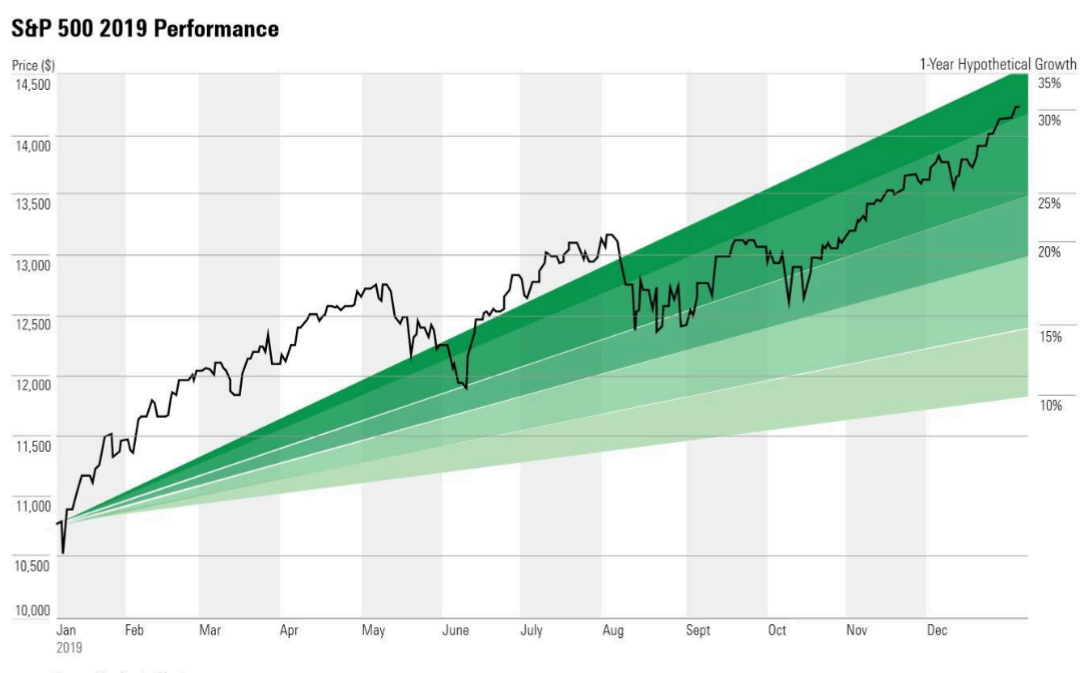
Ashley spent Saturday, Nov 2nd, volunteering to assist lower-income individuals with their financial planning questions in St Paul. He's been a regular participant since 2010.

San Francisco Client Visit in October

It was great to visit with friends and clients at the end of October. It was also fun to take a ride over the Golden Gate bridge courtesy of the AWS Cycling Club / Rapha Cycling. I went through Mill Valley and up Mt Tam. Perhaps a tradition in the making!

Q4 and 2019 Global Market Performance Report

It was a bull-market year for both bonds and stocks as investors shook off worries about global economic growth, trade wars, and geopolitical uncertainty with the help of a renewed round of official interest-rate cuts. Lifted by three Federal Reserve easings, the S&P 500 overcame spring and summer slumps to finish the year up 29%, the best advance since 2013. This was a significant reversal from the end of 2018, when investors in stocks, bonds, and commodities were spooked by concerns that the global economy was headed toward a recession.



Upcoming Travel

Costa Rica: Jan 20th - 23rd
San Francisco, CA: Jan 27th - 29th
Vail, CO: Feb 10th - 14th
Australia: Feb 26th - Mar 8th
New Orleans, LA: Mar 18th - 20th

The fourth quarter was particularly strong for riskier investments. Although the majority of major global markets netted positive gains for the quarter, it was the Morningstar Emerging Markets Index that came out ahead, erasing second- and third-quarter losses to gain 15.2% for the year. Corporate bonds also had their best year in the past decade, with the Morningstar US Corporate Bond Index returning 14.2%.

The risk-reversal during the fourth quarter can be seen in the reversal in the top and bottom indexes between the third and fourth quarter, particularly between utilities – a safe-haven, dividend play – and real estate, although the real estate sector has had a strong year, returning 27.1%, lifted by the combination of lower rates and an economy avoiding recession. Much of the focus during the year, however, was on the bond market, where an inverted yield curve had fueled fears that a slowing U.S. economy would tip into recession. By year-end, however, the Fed's rate cuts had restored the yield curve to its usual upward slope and lessened expectations that a recession was on its way.

The Fed's shift toward cutting rates in 2019 was a major driver of market sentiment, even as the back-and-forth headlines around the ongoing trade dispute between the U.S. and China fueled short-term swings. But along with the easier stance from the Fed, investor anxiety about the trade war cooled, leading the strong advance of U.S. stocks in the fourth quarter.

Lessening trade-war tensions benefited non-U.S. markets as well. In particular, the Morningstar China Index gained 12% in the fourth quarter, contributing to the year's 24.5% return. Other strong markets in 2019 included Russia, which posted a 12.5% gain for the fourth quarter and 38.9% return for the year following multiple rate cuts to curb falling inflation by the Bank of Russia. Emerging markets were also strong, such as Brazil, with 11.5% returned for the fourth quarter and 34% for the year.

Market volatility also cooled dramatically late in the year. There were only six days in the fourth quarter that the S&P 500 gained or lost more than 1% (all occurred in the month of October), compared with the third quarter's tally of 11 days. There were 38 days with 1% swings for all of 2019 and only seven that gained or lost more than 2%.

Reflecting the relative calm in the markets in the fourth quarter, there were only 21 days where the S&P 500 gained or lost more than 50 basis points, while the third quarter had 33.

Across global markets, the fourth quarter was the least volatile quarter all year. For both emerging markets and international developed markets, the three-month period was the quietest from a volatility standpoint since 2017's fourth quarter.

On the flip side, the grind higher in stocks is now limiting attractive buying opportunities, and Morningstar analysts consider both U.S. and Brazil markets overvalued. (Country-level valuation is derived from the aggregate price to fair value of the index's constituents, weighted by market cap.) But Chile's dismal fourth quarter, the worst globally with an 8% loss, leaves that market undervalued.

Growth stocks continued to outperform by a wide margin. In fact, 2019 marked the third year in a row that growth came out ahead across all market caps. Looked at across quarterly time periods, value has only outperformed during market declines, as was the case in the third quarter of 2019 and the fourth quarter of 2018.

At the stock sector level, healthcare topped other sectors with a 14.8% return for the quarter. These high gains didn't persist through the year, with healthcare trailing other sectors with a 21.8% annual return.

The technology sector's eye-popping 46.7% annual return drove 2019 gains, and financial-services companies, specifically payment processors like Mastercard (MA) and Visa (V), have climbed with 58% and 42% respective annual returns. But gains were broad-based, as over 90% of the stocks in the S&P 500 saw positive returns in 2019.

In 2019, the Morningstar Narrow Moat Index came out ahead of its wide-moat counterpart by a hair, and both outperformed the general market. This growth was primarily driven by Apple (AAPL) returning 31.5% this quarter, 89% for the year. Apple is the largest weighting in the narrow-moat index, at an 11.2% weighting. (The second-largest constituent is Exxon Mobil [XOM] at 2.9%.) Other top weightings that had a strong fourth quarter include Citigroup (C) with a 16.5% quarterly return, Netflix (NFLX) with 20.9%, and Nvidia (NVDA) with 35.3%. In addition, Advanced Micro Devices (AMD) more than doubled its size in 2019, seeing an 148.4% annual gain and a 58.2% fourth-quarter gain.

This year's outperformance for the Morningstar Narrow Moat Index was not a flash in the pan; the narrow-moat index outperformed its wide-moat counterpart six out of the past 10 years. If a company's moat rating is a proxy for quality, lower-quality stocks should outperform in bull markets over the long term, as investors are compensated for taking on more risk.

Meanwhile, a number of the Morningstar Wide Moat Index's top constituents posted more-restrained gains in 2019. This included Amazon.com (AMZN) with 6.5% for the quarter and 23% for the year and Berkshire Hathaway (BRK.B) with 8.9% for the quarter and 10.9% for the year.

Although both stocks and bonds posted overall gains during 2019, bond and stock performance has for the most part remained negatively correlated, meaning investors see bonds as a safe hedge against equity prices.

The following chart looks at monthly correlation between the Morningstar US Market and Core Bond Index using daily returns. Although both indexes netted positive for the year, for most months, when one was higher, the other tended to be lower. For example, on Jan. 4, the equity index returned 1.7% and the bond index 0.2%. The next day, equity returned 0.3% and bonds 0.5%. Even though all these numbers are positive, they are still negatively correlated.

Low interest rates have increased investors' demand for high-yielding corporate bonds and low-quality debt and have encouraged companies to go on borrowing binges. In fact, 2019 was Morningstar US Corporate Bond Index's best year this decade, with a 14.2% gain. The last time the index reached double-digit territory was 2009, with an 18.4% annual return. Long-term core bonds had a strong year, also benefiting from rate cuts, as did emerging-markets bonds.

Gold has had its best year since the beginning of the decade, 2010, rallying despite the strong gains in the stock market and lack of inflation pressures. Protests in Hong Kong and Latin America and the approaching 2020 U.S. presidential election may have increased investors' desire for a safe haven. After a weak second quarter, oil prices ended the year on an upswing supported by OPEC production cuts and improved economic outlook in China.

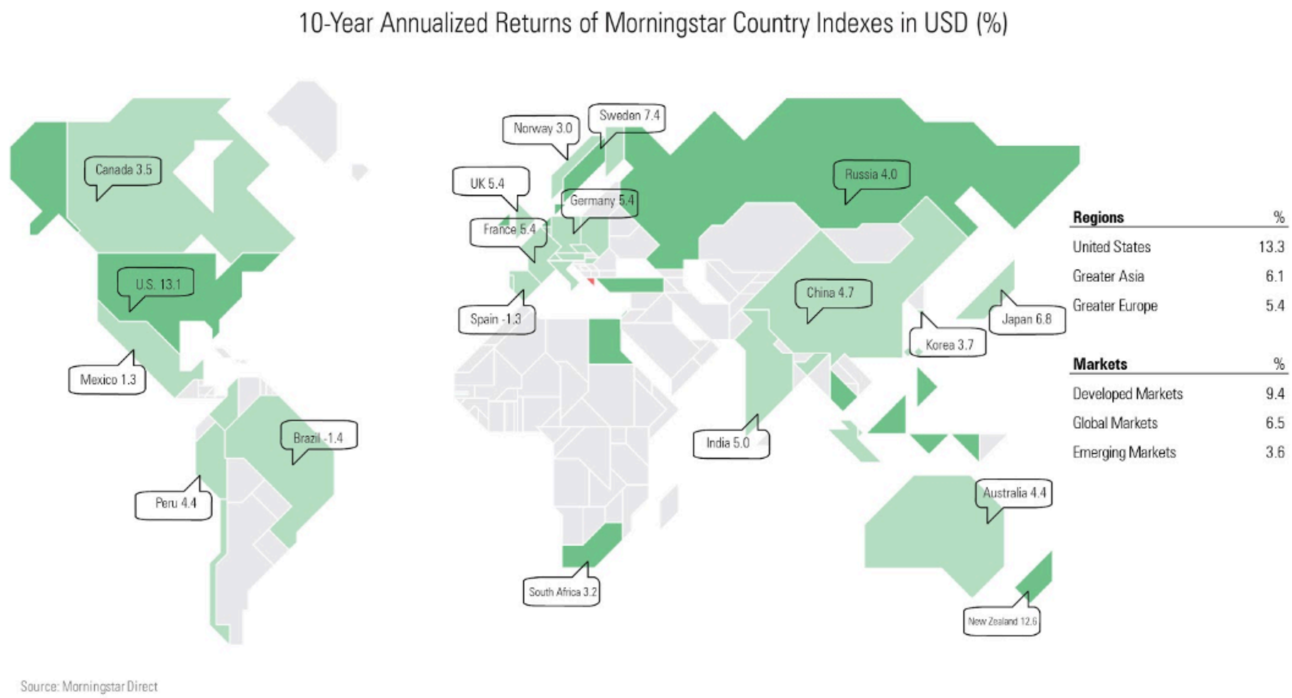
The euro's growth pivoted in the fourth quarter, with the U.S. dollar and yen heading in the opposite direction during the back half of 2019.

By Gabrielle Dibenedetto 03 Jan 2020 Morningstar

Performance Across the Decade

As the 2010s draw to a close, investors can look back on a decade where bull markets in both stocks and bonds repeatedly defied predictions that the good times would come to an end. The result: Those investors who stayed in the markets enjoyed solid long-term returns across their portfolios.

Here's a look at some of the major trends in the stock and bond markets from the past decade, starting with average annual returns for two major U.S indexes. It may be hard for many investors to remember now, but the 2000s were one of the worst decades in stock market history thanks to two bear markets, including, of course, the 2008 global financial crisis. By comparison, the 2010s were a banner decade, although average annual returns for the S&P 500 were less than the 1980s and 1990s. The S&P returned 13.3% for the last decade, led by 2013's 39.4% annual return.



While bond returns were positive for the decade, they've declined every decade for the past four. Quite simply, bond returns have been capped by the low absolute level of yields as the slow recovery from the financial crisis was accompanied by record-low official interest rates that lasted for much of the decade.

Not only were interest rates low, but over the course of the decade, there was little in the way of ups and downs. A comparison of highs and lows for U.S. Treasury bond yields over the past two decades tells the story. During the 2000s, the lowest yield hit by the U.S. Treasury 10-year note was 2.08% in December 2008. Meanwhile, the 10-year yield hit a low of 1.37% in July 2016 and managed a decade-long high of 4.01% only in April 2010.

The bull market for stocks was a global phenomenon. Despite continued volatility in emerging markets, countries such as New Zealand, Denmark, and the United States led the returns. Greece suffered the worst, with its financial crisis early in the decade taking the eurozone to the brink of collapse. In the United Kingdom, uncertainty plagued markets, and U.K. stocks returned an annualized

5.4% for the decade. Japanese stocks lagged, and China, where markets struggled at the tail end of the decade, also had relatively low returns at less than 5% a year.

When looked at more broadly across asset classes over the course of the decade, U.S. and emerging-markets stocks dominated. Meanwhile, in three of the past four years, intermediate government bonds and core bonds performed the worst across asset classes. Commodities were a mixed bag over the past 10 years.

Within the U.S. stock market, the dominant themes were the long economic expansion and the transformation to the digital economy. Consumer cyclical stocks nose out technology stocks as the best-performing Morningstar sector, returning 16.5% to tech shares' 16.2% return. Healthcare, despite continued uncertainty on the policy front, wasn't far behind with a 15% return.

By contrast, the 2010s were a dismal decade for energy stocks, as the industry's success in extracting more oil via fracking, along with generally slower-than-trend global economic growth, kept oil prices depressed for the much of the decade. Oil started off 2010 around $76 a barrel and is heading into the 2020s below $60.

As a result of these performance trends, the overall composition of the stock market has shifted meaningfully from a decade ago. Investors with exposure to the broad stock market have an even bigger portion of their portfolios in technology stocks, much more in communications (which includes Google) and basic materials, and far less in industrials and energy stocks.

The outperformance of consumer cyclical and tech stocks led to another major feature of the 2010s' stock market landscape: the significant outperformance of growth over value.

Mid-value stocks may have posted the best annual return for any of the nine Morningstar Style Box indexes over the past 10 years, but for most of the decade, growth stocks have dominated by a wide margin. (Morningstar Direct and Office clients can check out our three-part series on the performance gap between growth and value funds.)

Small-value stocks had a couple of strong years--they performed the best of all style box categories in 2012 and 2016--but for most of the second half of the decade, those stocks have lagged by a wide margin.

By: Katherine Lynch and Tom Lauricella, 18 Dec 2019, Morningstar

The SECURE Act - What it Means

A bill entitled The Setting Every Community Up for Retirement Enhancement (SECURE) Act passed the U.S. House of Representatives last May by an overwhelming majority, and it was called the most comprehensive, sweeping retirement security legislation in recent history. A few days ago, the

Senate finally passed the same legislation by attaching it to its December spending bill, meaning this sweeping legislation is now the law of the land.

But how comprehensive and sweeping is it really? Does it address the chronic unpreparedness of millions of Americans for retirement? Does it simplify the process of saving for retirement? Let's lay out the provisions, so you can decide for yourself.

1) The Act will finally allow people who are working beyond age 70 1/2 to make IRA contributions. People older than that could already keep contributing to Roth IRAs and 401(k) plans, so investors might be inclined to shrug their shoulders.

2) The Act would delay the date when people (whether retired or not) would have to start taking distributions out of their IRAs (called required minimum distributions, or RMDs) until age 72. This is not a huge concession, since the previous start date for RMDs was age 70 1/2. We are basically being given an extra year and a half of compounding before we have to take money out (and pay taxes on it) whether we need it or not.

3) Under the Act, small businesses will find it easier to group together and offer a 401(k) or other plans together, rather than individually—potentially reducing the financial barrier to creating a plan for employees. Plus… any business that sets up its first 401k) plan will receive up to a $5,000 tax credit for doing so (up from the previous $500). The Bureau of Labor Statistics says that only about 55% of all civilian workers, full or part time, currently participate in a workplace retirement plan. Will this $5,000 incentive and permission to group plans together make a dent in that figure, or not?

4) The SECURE Act allows employers to auto-escalate their employees' 401(k) contributions up to 15% of their pay, up from 10% currently.

5) People will be able, under the new rules, to withdraw money from their retirement accounts to cover the cost of the birth or adoption of a child.

6) The SECURE Act creates a safe harbor for qualified plan sponsors to offer annuities as an investment vehicle. You probably know that annuities come in many flavors, including those that provide a guaranteed income for life, and those that are mainly used as expensive investment vehicles. There is nothing in the provision that would prevent salespeople from selling high-commission annuities to the 401(k) market (this is where the lobbying push to pass SECURE came from in the first place), so everybody will need to be careful.

In addition, every 12 months, plan sponsors will have to report the monthly income that their participants would receive if they put the balance of their plan assets into an annuity. This, of course, will be a nice sales hook for annuity salespersons, but once again, participants should be careful. If they lock up their money in an annuity, the guaranteed income for life comes at the cost of flexibility. People

would not be able to take out, say, $5,000 to repair their roof, or have access to the cash in an emergency.

7) The Act will change the rules for people who inherit an IRA or other retirement vehicle. Previously, these inheritors were prohibited from allowing the assets grow tax-free forever; instead, they had to take RMDs based on their age. Younger people would have lower RMDs than older inheritors, and the percentage that had to be taken out would go up incrementally each year. This was known as the "stretch" IRA, because people could "stretch" out the distributions over their lifetime, and enjoy tax-free compounding of the money they were not required to take out.

Under the SECURE Act, the inherited IRA must be distributed, in full, by the end of the tenth year after it is received—and all ordinary income taxes would be due at the time of the distribution. This provision will require some planning for people who have larger IRAs, because their heirs will often be required to take out the full amount during their peak earning years. And inheritors of IRAs should think twice about waiting to the last minute to take the full distribution. Yes, waiting would increase the time that the assets would be compounding tax-free, but when all the money comes out at once, it could put the recipient in a higher tax bracket. As a result, many tax practitioners are recommending that wealthier individuals look at the possibility of doing partial Roth conversions while they're still alive, moving some of the traditional IRA assets into Roth IRAs and paying taxes at today's low rates. For the person inheriting a Roth IRA, all distributions are tax-free.

The question many people are asking is: are these provisions likely to move the needle on America's retirement crisis? The biggest major retirement legislation in a decade just shows how little retirement legislation we've been getting out of Congress.

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Introducing the New Apple Card

You have to wonder how the banker's employees feel. Goldman Sachs, the huge New York-based investment bank, devoted an entire department to the launch of the newly-announced Apple Card. Yet Apple chose as a tagline for its advertisements: Apple Card is Here—Created by Apple, Not a Bank.

The Apple Card is actually issued by Goldman Sachs, but what most consumers will see is a digital card that lives in the Wallet app on their iPhones. You can also get a physical card made of titanium, which provides your data on a chip, without having your card number, expiration date, CVV security code or signature displayed on it. (One wonders how its users will make online purchases.)

There is no doubt that the Apple Card represents a step up in convenience. When you're in the store, you simply display the card on your phone to make the purchase. Your iPhone carries a unique device number, and Touch ID or Face ID will provide the merchant with a one-time security code, with no signature required. Apple will provide weekly and monthly summaries of your spending, displaying (unlike many banks and credit card companies) the merchant names, locations and dates for each transaction.

Apple Card does not have an annual fee. And like many cards, there are cash-back features on all Apple Card purchases. You get 1% cash back when you use the physical card, 2% when you use your phone, and 3% when you buy products and services directly from Apple, including iTunes, the App Store and iCloud storage. The money is actually stored in your Apple Cash account, which can be used to pay off your Apple Card balance.

But also like most cards, Goldman Sachs will collect its pound of flesh on any balances that are not paid off, and it's clear that, despite the tag line, the bank had a hand in designing how much to charge. The interest rates (depending on your credit score) will range from 13.24% APR up to 24.24%. The national average of all credit cards, according to CreditCards.com, is 17.67%, so people with good credit are getting somewhat of a deal, while those with low credit scores might be better off using a different card.

Also: Apple will charge a 1 percent fee to make a transfer from Apple Pay Cash to a debit card. People using the Apple Card can send digital money to other iPhone users, which is a relatively new feature in the marketplace.

For all its convenience and the purported independence from the banking industry, the Apple Card is actually not the best deal in the credit card universe. The Blue Cash Everyday Card from American Express gets you 3% cash back at U.S. supermarkets, 2% cash back at gas stations and many department stores, and 1% cash back on other purchases—all with no annual fee. You can also get a welcome bonus of a $150 statement credit if you spend $1,000 within the first three months. The Chase Freedom Unlimited Visa card, also with no annual fee, provides 3% cash back in the first year up to $20,000 spent, with unlimited 1.5% cash back thereafter. Plus it offers a 0% intro APR for the first 15 months from account opening on purchases and balance transfers—but the APR is somewhere between 17.24% and 25.99% after that.

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Global Market Capitalization

One of the unexpected results of the recent rally in American stocks, combined with a market malaise throughout the rest of the world, is that U.S. companies, in aggregate, now make up more than 40% of the global market capitalization of all publicly-traded stocks. This is up from just over 32% ten years ago. What makes this more remarkable is that two-fifths of the market opportunities have been generated in a country that makes up just 6.2% of the world's population.

Japan's total market cap ranks in a distant second place, with 7.59% of the total—down from 8.02% ten years ago. But Japan is still punching above its weight; its population represents 1.66% of the world's total. Similarly, the United Kingdom's publicly traded companies make up 4.49% of the world's total (down from 6.83% ten years ago), while England's total population is just 0.86% of all the people in the world.

Among other big disparities: China's publicly-traded companies make up just 7.51% of the world's total, even though China makes up 18.2% of the world's population. The disparity is even greater in India, whose companies make up 2.83% of global market cap despite India representing 17.5% of the world's population.

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Common Estate Planning Pitfalls

Estate planning is complicated. There are a lot of moving parts to organizing your finances and determine where they will go after your death. And in many cases, people simply sign a stack of documents at their attorney's office and think the job is done.

The result? A lot of mistakes, a lot of people falling into estate planning pitfalls. Here are a few that you should try to avoid.

1) Naming the wrong executor. These are the people who are appointed to take legal control over the assets when you pass away. Executors collect all the assets of the deceased, pay final debts and expenses, and file federal and state estate tax returns (if needed). Unfortunately, it is not uncommon for the named executor, years after the documents have been signed, to be deceased or no longer suited for the position because he/she is too elderly. If a professional is named, is the attorney or CPA still in business? Meanwhile, children who were too young to serve when the documents were signed may now be capable of taking on the executor role.

Solution: periodically check to see who has been named as the executor in the estate documents. Is that still appropriate?

2) Not updating documents to reflect the maturity and financial conditions of the children. Estate planning documents that were created when children were young will have named a guardian, but when the children reach maturity, that would no longer be necessary. The document may leave assets to trusts on behalf of the children, when it makes more sense to distribute them directly to the adults they have become. And in some cases, an unequal distribution of assets might make sense, if one adult child has become financially successful while others are struggling. Finally, when children are minors, they typically don't need health care powers of attorney, living wills or advance health care directives. Once they become adults, they should consider having these documents in their own right.

Solution: check to see the provisions in your will or trusts that relate to the children, and update as necessary.

3) Inappropriate health care directives. Under the Health Insurance Portability and Accountability Act, every individual's medical records and other personal health information is confidential, meaning it cannot be shared with anyone, including family members, without written authorization. Lack of this information and specific directives could impede decision-making by others when you're incapacitated or approaching the end of your life.

Solution: check and update your family's health care powers of attorney, living wills and advanced health care directives.

4) Inappropriate estate tax provisions. In 2019, individuals are legally permitted to transfer assets valued at $11.4 million ($22.8 million for married couples) free of federal estate and gift taxes. But outdated estate documents might include planning that was appropriate for much lower exemption values—for example, forcing a trust for the heirs to be funded up to the applicable exclusion amount, which might impoverish the surviving spouse.

Solution: review the formulas in the estate documents with your attorney and/or tax professional.

5) Estate documents drafted in a state where you no longer reside. Every state has its own estate and income tax laws; some are common law property states while others are drafted with community property laws. There can be significant differences between them when it comes to transferring assets. Moreover, 17 states also impose some form of estate or inheritance tax, with different exemption amounts. Some estates that would not be subject to a federal estate tax might be subject to state estate taxes. If your documents were drafted in a different state from where you currently reside, they could be outdated and misapplied.

Solution: review your estate plan to see if it is still appropriate, with an eye toward reducing state estate taxes and making sure they reflect your current residency.

6) Not utilizing portability. The federal estate rules say that a surviving spouse can take advantage of any unused portion of the spouse's exclusion amount. But that's only true if the estate files a federal estate tax return within nine months of the deceased's passing. (This can go up to 15 months if an extension is granted.) In the normal case where the deceased's estate would not have to pay estate taxes, often nobody realizes that the federal estate tax return (showing zero taxes have to be paid) has to be filed. This can be costly in some larger estates, where the second spouse dies with more than $11.4 million in wealth.

Solution: Some families set up a credit shelter, bypass, family or exemption trust that would be funded with assets from the first spouse's estate. That preserves not only the portability of those assets, but any growth in those assets would not be counted in the estate tax calculation. The surviving spouse could also disclaim part of the deceased's assets, allowing them to pass to the children. Or the executor of the estate can file a federal estate tax return, preserving the portability of $11.4 million of additional estate tax exemption.

7) Failing to plan for capital gains taxes. Most estates will never pay a federal estate tax, which means that the tax planning should be concentrated on income tax planning. One important consideration is the step-up in basis for appreciated assets, which means that, for the heirs, the capital gains tax obligation on the amount of appreciation during the deceased's time of ownership will vanish. This is the closest thing to a free lunch, in the tax world, that you can get.

Solution: Save some highly-appreciated assets like legacy stock positions and shares of the family business from the normal rebalancing and diversification activities, and pass them on to heirs.

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